

Intellectual property basics for startups: trade secrets

By Victoria Lee

The crown jewels of a typical technology company are often found in its intellectual property portfolio. Having a good basic understanding of intellectual property protection is essential for entrepreneurs to extract value out of their company's key assets and manage opportunities and risk arising from them. Among these key assets is the trade secret.

What is a trade secret?

Trade secrets are information of any type that is valuable to its owner because it is not generally known in the industry and its owner has taken reasonable steps to maintain the information in confidence. Examples of trade secrets include customer lists, source code, and semiconductor manufacturing processes. Trade secrets can include both positive and negative information. For example, the knowledge of which compounds are not effective therapeutic drugs against cancer can be very valuable and save a company tens or even hundreds of millions of dollars. Trade secrets arise automatically if a company takes the appropriate steps to maintain the information as a secret and they continue to be enforceable so long as they meet those criteria. Consequently, a trade secret can endure forever. Trade secret law provides rather limited protection: it prevents the "misappropriation" of the trade secret. Misappropriation of a trade secret requires "wrongful" taking. For example, a classic example of trade secret misappropriation occurs when an individual takes confidential information from his employer to start a new company. On the other hand, reverse engineering, unless such reverse engineering breaches an agreement, is not misappropriation.

Trade secrets have long been governed by state law with most of the states adopting their own versions of the Uniform Trade Secrets Act (Massachusetts and New York being the only exceptions). On May 11, 2016, the Federal governments enacted the Defend Trade Secret Acts. This new law requires that employee inventions agreements and contractor agreements with individuals (not contractors or consultants that are entities) that are executed or updated (*ie*, amendments or modifications to existing agreements) beginning on May 12, 2016 include notice of certain immunities provided under the law. The law gives an employee and individual independent contractor immunity from civil and criminal liability under state and federal law for disclosing a trade secret if the disclosure was made to report or investigate an alleged violation of law and the new law requires that companies include notice of such immunity in any agreement with an employee or independent contractor that governs the use of trade secret or confidential information. Failure to provide this notice would result in the company not being able to recover exemplary damages or attorneys' fees from the employee if the company were to sue the employee for misappropriation of trade secrets.

When do you protect information as a trade secret?

Most products and services can be protected by a combination of intellectual property rights. For example, computer software can be protected by patents, copyrights, trademarks and trade secrets. Microsoft protects certain functions of its Windows software with patents; it uses copyright to protect the actual code of the Windows software from copying; it uses trademark law to protect the "Microsoft" and "Windows" trademarks which identify the product; and it uses trade secret law to protect the structure and methodology of its source code. However, once a patent is issued, trade secrets in the part of the computer software protected by the patent will be disclosed and will no longer be protected by trade secret law.

Because patent applications are published and made available to the public during the application process, inventions covered by patents are not protectable as trade secrets. Some companies may want to keep an invention as a trade secret for competitive market reasons and so may opt not to pursue patent protection and instead rely on trade secrets to protect their intellectual property assets.

Some information may not be protectable as intellectual property other than as a trade secret. Examples of such information can include pricing and cost information (but not if that information is readily ascertainable from customers), profit margin information, recipes and customer lists (unless readily ascertainable from public sources).

What happens if my company does not own the trade secrets created by one of its founders?

The most common mistake by startups is failing to obtain proper written assignments or licenses of intellectual property rights that are developed by the founders prior to the startup's incorporation or rights developed by employees or consultants after the startup's incorporation. If a startup does not actually own or have a license to the intellectual property in its products, a disgruntled founder or employee can hold the startup hostage until the company either revises the product to remove his contributions or makes a deal to obtain assignment or license of the rights. A very common form of this problem is the failure to obtain the assignment of the intellectual property rights to the product developed by the founders either prior to incorporation of the startup or prior to the founders becoming employees of the startup. This mistake can be very expensive to resolve; in some situations, it can be fatal to the startup when it's seeking investment or about to be acquired.

A major risk for a startup is the use by founders of materials from their prior employer. Such materials can range from trade secrets such as customer lists or semiconductor design methodology to computer software. This mistake can cripple a startup, because companies are becoming more aggressive in defending their intellectual property rights: a lawsuit, even if the startup wins, can prove to be fatal either due to delays in product introduction or distraction of the startup's management. If the startup loses, it will need to recommence its product development and may have to pay substantial damages. In more serious cases, the founders can be subject to criminal liability and may even serve time in jail.

For a sample form of independent contractor agreement that would be used by a company hiring a contractor who could develop trade secret information for the company, see our [Starter Kit](#) for a form of independent contractor agreement.

Where do I find sample agreements that I can use to protect my company's trade secret information?

The most typical way a company protects its trade secrets is through the use of non disclosure agreements when it is disclosing trade secret and other confidential information. For different forms of non disclosure agreements, please see the mutual confidentiality agreement and two forms of one-way confidentiality agreement in our [Starter Kit](#).

The form of employee proprietary information and inventions agreement also includes typical confidentiality obligations that protect the company's trade secret information. You can find that form agreement in our [Starter Kit](#).

What are alternatives to an assignment of a trade secret?



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Sometimes an outright assignment of a trade secret may not be possible. Short of getting an assignment, it may be sufficient for some startups to obtain a broad exclusive, perpetual and irrevocable license. Such licenses may be royalty bearing or royalty free.

What do I do if I have a question?

If you have questions about ensuring that your company has all the intellectual property rights it needs to get started we're here to help. Reach out to our Technology Sourcing and Commercial practice.

If you have questions about whether or not there is a risk of a former employer making a trade secret misappropriation against one of your employees or the company, please contact our Commercial Litigation practice.

In the meantime, feel free to review our starter kit for forms of employee inventions and proprietary information agreement, independent contractor services agreement and founder stock purchase agreement with intellectual property assignment.

Also, if you're interested in learning more about copyright protection in other key jurisdictions around the world, see the IPT volume in our "Guide to Going Global" series. The current version provides an overview of intellectual property protections and key commercial terms in over 35 countries.

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